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Office of the Secretary
Federal Communications Commission
1919 M. Street N.W.
Washington, DC 20554

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

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Ladies and Gentlemen:

We are writing to express our concern regarding the treatment of stock options, warrants and similar instruments in the Fifth Report and Order, PP Docket No. 93-253 (the "Order"). The Order provides that these instruments generally are given present effect and are deemed to have been fully exercised in determining financial eligibility for the entrepreneurs' blocks and in determining affiliates of applicants. We believe that if this treatment is applied to all such instruments and related mechanisms for the sale of equity, it will be impossible for most businesses owned by members of minority groups and/or women to raise the necessary capital to compete successfully in the auctions for the entrepreneurs' blocks licenses, thereby drastically reducing the number of such designated entity PCS licensees.

Section 24.709(b) of the Code of Federal Regulations (the "Commission Rules"), which explains financial eligibility requirements for the entrepreneurs' blocks, provides that ownership interests will be calculated on a fully diluted basis; all agreements such as warrants, stock options and convertible debentures will generally be treated as if the rights thereunder already have been fully exercised. Section 24.720(1)(5) of the Commission's Rules, which defines the term "affiliate", provides that stock options, convertible debentures, and agreements to merge are generally considered to have a present effect on the power to control the concern. Similarly, Section 24.720(c), which defines "business owned by members of minority groups and/or women" provides that "all agreements such as warrants, stock options and convertible debentures will generally be treated as if the rights thereunder already have been fully exercised." We understand that the FCC views the existence of these instruments as a de facto transfer to the holder of the instrument of the equity interests subject thereto.

As the Commission noted in the Order, it expects broadband PCS "to be a highly capital intensive business requiring bidders to expend tens of millions of dollars to acquire a license and construct a system even in the smaller broadband PCS markets" (§174) and "women and minorities have especially acute problems in obtaining financing, due in part to discriminatory lending practices by private financial institutions." (§160) The key question is whether the Order will enable members of minorities and/or women to obtain the necessary capital. We believe that a blanket rule giving present effect to all pre-existing arrangements to transfer equity will make it impossible for most minorities and/or women to raise the capital necessary to compete successfully in the PCS auctions, thereby defeating the important congressional mandate of ensuring that such designated entities be "given the opportunity to participate in the provision of spectrum-based services." 47 U.S.C. Section 309(j)(4)(D). Our reasoning is as follows.

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Capital from traditional sources largely will be unavailable to designated entities prior to the auction. Banks generally will not be lending to stand-alone PCS businesses due to the high level of risk, uncertainty and unproven track record of PCS. Venture capital will be unavailable, even if attractively priced, because the desire of venture capital firms to be able to take control if things go bad and to have a clear exit strategy are likely to run afoul of the control requirements of the PCS rules. PCS licensees may be able to access vendor debt after the auctions, but this will be of no help to designated entities pre-auction. Discounts and installment payment options available to minorities and/or women under the PCS rules will help to mitigate capital needs. However, significant capital outlays will still be necessary to meet (i) pre-auction, upfront payment obligations, (ii) 10% of the cost of the PCS license, (iii) construction costs for the PCS system (unless vendor debt is available and attractively priced), and (iv) operating losses of the PCS business going forward.

The Order provides that members of minorities and/or women may sell up to 75% of the company's equity provided that no single investor may hold 25 % or more of the firm's passive equity and the minority or women must own 51% of the voting equity. We do not believe that even this accommodation will enable minorities and/or women to obtain the necessary capital. In the first place, even 25% of equity could require a substantial sum of money unless, which is unlikely, substantial debt financing is available. Second, any substantial equity investor without any voice in control would want a way to realize upon its investment within a reasonable period of time. Absent the ability to utilize puts-calls and other customary exit techniques, the only sure method of timely exit would be to require a limited life for the company, thus forcing all the investors, including the minority members and/or women, to terminate their interest at a specific time whether they want to or not. Further, the requirement that no single investor may hold more than 25% would require a minimum of three passive investors and effectively rule out strategic investors.

We strongly urge the FCC to modify its rules regarding the present effect of pre-existing arrangements to transfer equity in order to enable members of minorities and/or women to raise the necessary capital for the PCS auctions. Specifically, only pre-existing arrangements that would not give minorities and/or women the opportunity to continue a substantial ownership interest in the company or would prevent minorities and/or women from enjoying the increase in value of their equity interest should be treated as resulting in a de facto transfer of control. For example, mutual rights of first refusal,

and put/calls based on cash flow multiples or appraised fair market value should be permitted. These are just two examples of important tools that minorities and/or women can utilize to compensate passive investors for the use of capital. These types of arrangements, coupled with existing safeguards in the PCS rules, will be adequate to ensure that de facto control remains in the hands of the control group for a substantial period of time. Importantly, the unjust enrichment rules would recapture bidding credits if the arrangements shifted control before the expiration of the ten-year license.

It will be impossible for designated entities to attract capital for PCS if there is any uncertainty regarding the treatment of pre-existing arrangements to transfer equity. We therefore recommend that the FCC establish a "bright line" test regarding this issue. One such test might be the following:

Options, warrants and similar arrangements will not be treated as if they were exercised if, in the case of a designated entity controlled by minorities or women, (a) the arrangements may not be exercised until the fifth year after the license has been issued, (b) such arrangements are either mutual (that is, similar arrangements are in effect for the benefit of the minority/women control group) or can be purchased by the control group at fair market value immediately prior to their exercise, and (c) following the exercise of such arrangements the minority/women members of the control group will be entitled to retain a 10% or more equity interest in the designated entity.


The FCC can further enhance the ability of designated entities to raise capital for PCS by making two additional modifications to the rules. First, the FCC should strongly consider allowing women and/or minorities to sell up to 75% equity to a single, passive investor (while retaining the rule that the women or minorities maintain 50.1% voting control). The 25% passive investor limitation is unattractive to strategic investors, who view other passive investors as problematic. Secondly, the FCC should seriously consider allowing women and/or minorities to partition PCS licenses after an appropriate period of time. This, coupled with our other suggested changes to the rules, will allow women and/or minorities to fashion arrangements to transfer equity (as a means of raising capital) that enable them to stay in the PCS business, thereby furthering one of the fundamental goals of Congress in enacting the PCS rules.

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Thank you for your consideration.

Very truly yours,

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